MEDPAC Medicare Payment Advisory Commission

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Durable medical equipment payment system

Medical equipment needed at home to treat a beneficiary' illness or injury is covered under the durable medical equipment (DME) benefit. Medicare spent about $7 billion on DME in 2003, about 3 percent of fee-for-service program spending.

Wheelchairs and respirators are typical of the equipment Medicare pays for under this benefit. To be covered, the equipment must:

- withstand repeated use,
- primarily serve a medical purpose, and
- generally not be useful to a person without an illness or injury.

Thus, expendable supplies, such as bandages or incontinence pads, or otherwise useful equipment such as a humidifier, would not be covered under this benefit.

Medicare also covers prosthetics, orthotics, and some medications under its DME benefit. Covered prosthetics generally are artificial limbs; orthotics include orthopedic braces and some supportive garments. Medication that is necessary to the function performed by durable equipment is also covered under this benefit—for example, heparin administered in a home dialysis system, albuterol in a nebulizer, or chemotherapy drugs in an infusion pump.

The equipment Medicare buys

Medicare uses fee schedules to set prices for non-customized equipment, prosthetics and orthotics. These items are assigned to categories and to product groups within those categories. The categories are based on the nature of the item: whether or not it is inexpensive, needs frequent service, or is a rental item subject to an explicitly limited period of use. The categories are:

- inexpensive or routinely purchased equipment,
- items requiring frequent and substantial servicing,
- prosthetic and orthotic devices,
- capped rental items, and
- oxygen and oxygen equipment.

Within the categories, items are further categorized into about 2,000 product groups. Examples of product groups are high-strength lightweight wheelchairs and rental portable oxygen systems. All items within the same product group have the same payment rate.

The central issue in DME payment policy is the frequent failure of Medicare's payments to reflect current market prices. It is difficult for CMS to price DME in a way that is consistent with the market because the product definitions are too broad. While each product group has only one payment rate, the same product group can be used for many different items with varying prices in the retail market. Also, changing Medicare's payment rates in any way other than simple updating has been cumbersome.

CMS tested competitive bidding as a new method of purchasing DME in two areas between 2000 and 2002. In that demonstration, competitive bidding lowered prices for selected DME items between 17 and 22 percent. Preliminary analyses of the demonstration did not find serious quality or access issues.

Setting the payment rates

To ensure beneficiaries' access to needed DME, the prices that Medicare pays must cover efficient suppliers' costs of furnishing equipment for rental or purchase. Generally, the current fees are an average of the allowed charges from 1986 and 1987, adjusted by the CPI-U to account for inflation.

To capture geographic differences in prices for equipment, Medicare uses a separate fee schedule for each state. The state fee schedule prices are subject to a national floor and ceiling to limit the variability in prices across the country. The fees for prosthetics and orthotics are also determined state-by-state but are subject to regional limits. The applicable fee schedule is determined by the location of beneficiaries' residences rather than the location of the DME provider. All program payments are reduced by the 20 percent coinsurance paid by beneficiaries.

In addition to standard equipment, Medicare also purchases customized equipment and medications through this benefit but does not use the standard equipment fee schedules. The prices for customized equipment are determined item-by-item, by the regional carrier. Medications used in conjunction with DME are currently priced at a discount from the average wholesale price of the drug (AWP). In 2005, pursuant to the MMA, the prices for these drugs will be set at 106 percent of the average sale price (ASP). There are no state or regional variations in price of drugs that Medicare purchases through this benefit.

Over time, the inflation-adjusted prices have failed to reflect changes in medical equipment technology and other factors that have caused market retail prices to diverge from Medicare' payment rates. The Secretary has two alternatives to the inflation adjustment. One is adjusting prices by as much as 15 percent in one year for DME that is frequently purchased by other payers. To make the price adjustment, CMS would use an inherent reasonableness test based on a survey of market prices. The other alternative is freezing some prices or putting a limit on the amount of the annual increase.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (MMA) enacts several major changes to payments for DME. Based on the results of the competitive bidding demonstration, the MMA:

- Establishes a competitive bidding process for DME that will be phased-in nationwide, starting with ten metropolitan statistical areas (MSAs) in 2007 and expanding to 80 MSAs by 2009. In areas without competitive acquisition after 2009, Medicare may either apply competitive bidding payment rates from other areas or use its inherent reasonableness authority. Class III devices—those the FDA has categorized as new, unique, or new uses of a product—are exempt from the competitive bidding process;

- Freezes payments for DME from 2004 to 2008, or until competitive bidding is established. Payments for prosthetic devices, prosthetics, and orthotics will be frozen from 2004 to 2006, and updated by the CPI-U afterwards. Class III devices will receive payment updates from 2004 to 2006 equal to the CPI-U, and GAO will report in 2006 on the appropriate payment update for these products in 2007 and 2008; and

- Requires the Secretary to set payment amounts for certain products like oxygen and oxygen equipment, wheelchairs, and diabetic supplies by applying an update factor based on an OIG report on differences between Medicare and FEHBP payments for these products. Also, the Secretary is required to establish quality standards for DME and implement them through independent accreditation organizations.